Report

of the

Examination of

Fidelity and Guaranty Insurance Underwriters, Inc.

St. Paul, Minnesota

As of December 31, 2002

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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December 19, 2003

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Commissioners:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

FIDELITY AND GUARANTY INSURANCE UNDERWRITERS, INC.
ST. PAUL, MINNESOTA

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 2001 as of December 31, 2000. The current examination covered the intervening period ending December 31, 2002, and included a review of such 2003 transactions as deemed necessary to complete the examination.

An examination was conducted by the Minnesota Department of Commerce as the "Lead State", along with examiners from the states of Delaware, New York, Illinois, Maryland, California, and Wisconsin. The results and findings from the Minnesota examination were reviewed and appropriately incorporated into this examination report.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comments on the remaining areas of the company's operations are contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

An independent actuary was engaged by the Minnesota Department of Commerce. The actuary reviewed the adequacy of St. Paul Fire and Marine Insurance Company's loss reserves and loss adjustment expense reserves. The results of the actuarial work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuary's conclusion.

II. HISTORY AND PLAN OF OPERATION

Fidelity and Guaranty Insurance Underwriters, Inc. (hereinafter also FGIUI or the company), was organized in 1951, as a stock fire and casualty company, under the laws of the State of Ohio and commenced business on November 1, 1951. On October 1, 1994, the company redomesticated to Wisconsin. All outstanding stock is held by its parent, United States Fidelity and Guaranty Company (USF&G). In October 1981, through an exchange of stock, USF&G Corporation, a holding company, gained financial control of USFGC. In April 1998, the St. Paul Companies, Inc. (SPC), a holding company in Minnesota, acquired USF&G Corporation through an exchange of stock. Pursuant to an agreement and plan of merger effective January 1, 1999, between USF&G Corporation and St. Paul Fire and Marine Insurance Company (SPFMIC), a Minnesota domiciled property and casualty company, also part of SPC, USF&G Corporation was merged into SPFMIC.

The company writes direct premium in the following states:

New York	$ 16,667,366	11.8%
Texas	16,064,320	11.4
California	14,662,759	10.4
Florida	9,826,801	6.9
Georgia	7,296,988	5.2
New Jersey	7,123,034	5.0
Pennsylvania	4,836,541	3.4
Michigan	4,302,112	3.0
Mississippi	4,279,400	3.0
All others	56,467,054	39.9
Total	$141,526,375	100.0%

The premium written in Wisconsin was less than 1% of the total premium. The company is licensed in all states and the District of Columbia. The major products marketed by the company include commercial multiple peril, workers compensation, other liability-occurrence, commercial auto liability, fire, surety, allied lines, inland marine, auto physical damage, products liability-occurrence, and boiler and machinery. The major products are marketed through 2,145 agents and agencies throughout the United States.

The following table is a summary of the net insurance premiums written by the company in 2002. The growth of the company is discussed in the Financial Data section of this report,

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Fire	$12,469,692			$12,469,692
Allied lines	9,219,211			9,219,211
Homeowners multiple peril	(42,207)			(42,207)
Commercial multiple peril	31,848,087			31,848,087
Inland marine	2,631,971			2,631,971
Earthquake	299,005			299,005
Workers' compensation	17,469,064			17,469,064
Other liability - occurrence	24,356,010			24,356,010
Other liability - claims made	354,166			354,166
Products liability - occurrence	3,637,308			3,637,308
Private passenger auto liability	(212,783)			(212,783)
Commercial auto liability	20,651,012			20,651,012
Auto physical damage	5,558,923			5,558,923
Fidelity	264,967			264,967
Surety	10,236,916			10,236,916
Burglary and theft	14,012			14,012
Boiler and machinery	2,771,021			2,771,021
Total All Lines	$141,526,375			$141,526,375

Of the total direct written premium, 23% represented commercial multiple peril, 17% for other liability - occurrence, 15% for commercial auto liability, 12% for workers compensation, 9% for fire, 7% surety, 6% allied lines, and 4% for auto physical damage, while the remaining lines were individually under 3%.

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of three members. The directors are elected annually to serve a one-year term. Officers are elected at the board's annual meeting. Members of the company's board of directors may also be members of other boards of directors in the holding company group. The board members currently receive no compensation for serving on the board.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Marita Zuraitis Hydes, Maryland	Chairman, President & CEO FGIUI	2004
Bruce A. Backberg Woodbury, Minnesota	Sr. Vice President & Corporate Secretary FGIUI	2004
Thomas A. Bradley St. Paul Minnesota	Sr. Vice President & CFO FGIUI	2004

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2002 Compensation
Bruce A. Backberg	Senior VP & Corp. Secretary	$5,613
Thomas A. Bradley	Senior VP & CFO	$1,355
Paul J. Brehm	Vice President	$4,501
Sheila M. Brown	Assistant Vice President	$2,715
John R. Clifford, Jr.	Executive Vice President	$4,701
Paul H. McDonough	Vice President & Treasurer	$1,705
Robert Lamendola	Senior Vice President	$9,784
John C. Treacy	Vice President & Corp. Controller	$2,332
Marita Zuraitis	Chairman, President & CEO	$13,509

The above officers are paid by other affiliates of the company. The above salaries represent the amounts allocated to the company through the intercompany cost allocation agreement.

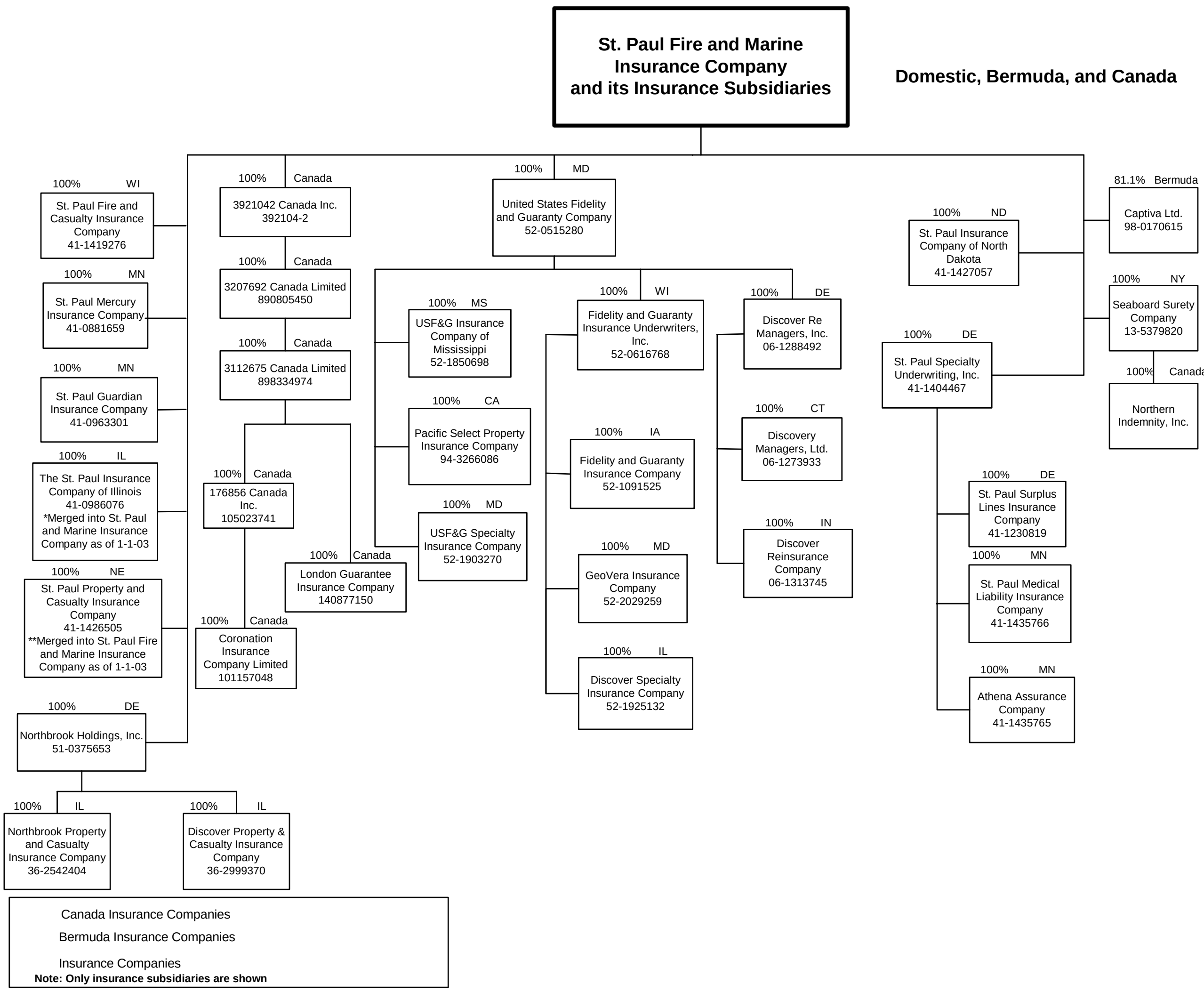
Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. There were no committees active at the time of the examination.

IV. AFFILIATED COMPANIES

Fidelity and Guaranty Insurance Underwriters, Inc (FGIUI), is a member of a holding company system. The organizational chart below depicts the relationships among the affiliates in the group that the company has agreements with or control of FGIUI. A brief description of the significant affiliates of FGIUI follows the organizational chart. Effective January 2001, an affiliate of the company, USF&G of Wisconsin, was merged into its parent, United States Fidelity & Guaranty Company.

Organizational Chart
As of December 31, 2002



The St. Paul Companies, Inc.

The St. Paul Companies, Inc. (SPC), is a widely-held publicly-traded holding company, incorporated in Minnesota and is the ultimate parent of the group. SPC is engaged in property and casualty insurance as well as investment banking and asset management. It provides investment management services for FGIUI and the group through its Investment Division. On April 24, 1998, SPC merged with USF&G Corporation. The merger was financed with SPC common stock valued at $3.6 billion, in a tax-free exchange of stock accounted for as a pooling of interest. USF&G Corporation and all of its subsidiaries are now wholly owned subsidiaries of SPC. As of December 31, 2002, SPC's audited consolidated financial statement reported assets of $39.92 billion, insurance reserves of $26.44 billion, debt of 2.71 billion, and payables and other liabilities of $4.14 billion, resulting stockholders' equity of $6.63 billion. Operations for 2002 produced net income of $218 million.

St. Paul Fire & Marine Insurance Co.

St. Paul Fire and Marine Insurance Co. (SPFMIC) is a property and casualty insurer domiciled in Minnesota. Most of the SPFMIC's business is written in workers' compensation, other liability-occurrence, commercial auto liability, medical malpractice–claims made, other liability-claims made, commercial property, and property reinsurance. SPFMIC also manages the St. Paul Investment Pool (short-term investments) of which FGIUI is a participant. As of December 31, 2002, SPFMIC's audited financial statement reported assets of $17,029,714,710, liabilities of $12,103,935,301, and surplus of $4,925,779,409. Operations for 2002 produced net income of $545,986,945.

United States Fidelity & Guaranty Co.

United States Fidelity & Guaranty Co. (USF&G) is a property and casualty insurance company domiciled in Maryland. Most of the USF&G's business is written in commercial multiple peril, private passenger auto, commercial auto liability, homeowner's multiple peril, auto physical damage, and surety. FGIUI has a tax sharing agreement with the other members of this group that is administered by USF&G. FGIUI also has a 100% quota share reinsurance contract with USF&G summarized in the Reinsurance section of this report. As of December 31, 2002, USF&G's audited financial statement reported assets of $4,982,032,076, liabilities of $3,183,587,023, and surplus of $1,798,445,053. Operations for 2002 produced net income of $424,698,982.

United States Fidelity & Guaranty Specialty Ins. Co.

USF&G Specialty Ins. Co. (Specialty) is a property and casualty insurer domiciled in the state of Maryland. Most of Specialty's business is written in homeowner's multi-peril. FGIUI has a reinsurance agreement with Specialty whereby FGIUI cedes 100% of its Florida homeowner's multi-peril policies to Specialty. This contract was entered into in conjunction with a consent order with the state of Florida. FGIUI was named in an overall agreement on this issue, but at the time did not sell homeowners coverage in Florida. As of December 31, 2002, USF&G Specialty's audited financial statement reported assets of $16,342,575, liabilities of $2,980, and surplus of $16,339,595. Operations for 2002 produced net income of $953,317.

Agreements with Affiliates

FGIUI has a services agreement with SPFMIC, whereby SPFMIC provides general and administrative services. SPFMIC also manages the St. Paul Investment Pool (short-term investments) of which FGIUI is a participant. FGIUI cedes 100% of its business to its parent, USF&G.

V. REINSURANCE

FGIUI cedes 100% of its direct business to USF&G, except homeowners written in Florida, which is ceded to Specialty . The contracts contain proper insolvency provisions. The terms of the intercompany reinsurance agreement are discussed below.

Affiliated Ceding Contracts

1.	Type:	100% Quota Share
	Reinsurer:	United States Fidelity and Guaranty Company.
	Scope:	All business lines of the company, except homeowners written in Florida
	Retention:	None
	Coverage:	100% of the in force liabilities and obligations of the company
	Premium:	Gross premium on all policies as written
	Effective date:	November 30, 1955
	Termination:	At any time by either party giving six months' notice in writing to the other
	Other:	The agreement also provides for 100% reimbursement by the reinsurer of underwriting expenses, premium taxes and commissions applicable to the subject business.
2.	Type:	100% Quota Share
	Reinsurer:	United States Fidelity and Guaranty Specialty Insurance Co.
	Scope:	All homeowners' multi-peril covering Florida risks
	Retention:	$0
	Coverage:	100% of the in force liabilities and obligations of the Florida risks written by the company (currently $0)
	Premium:	Gross premium on all policies written
	Effective date:	September 14, 1995
	Termination:	At any time by either party giving six months' notice in writing to the other

The company does not currently write Florida homeowners insurance.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2002, annual statement. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

Fidelity and Guaranty Insurance Underwriters, Inc.
Assets
As of December 31, 2002

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$45,596,576		$45,596,576
Cash	9,212		9,212
Short-term investments	437,443		437,443
Interest, dividends, and real estate income due and accrued	532,846		532,846
Receivable from parent, subsidiaries, and affiliates	132,428		132,428
Total Assets	$46,708,506		$46,708,506

The failure to add to the totals shown is due to rounding.

Liabilities, Surplus, and Other Funds
As of December 31, 2002

Other expenses (excluding taxes, licenses, and fees)	$ 7,450	
Total Liabilities		$ 7,450
Common capital stock	5,000,000	
Gross paid in and contributed surplus	18,000,000	
Unassigned funds (surplus)	23,701,056	
Surplus as Regards Policyholders		46,701,056
Total Liabilities and Surplus		$46,708,506

Summary of Operations
For the Year 2002

Investment Income		
Net investment income earned	$2,465,277	
Net realized capital gains or (losses)	25,199	
Net investment gain or (loss)		$2,490,476
Net Income		$2,490,476

Fidelity and Guaranty Insurance Underwriters, Inc.
Cash Flow
For the Year 2002

Net investment income		$2,642,155
Proceeds from investments sold, matured, or repaid:		
Bonds	$7,406,120	
Cost of investments acquired (long-term only):		
Bonds	(9,290,692)	
Net cash from investments		(1,884,572)
Cash provided from financing and miscellaneous sources:		
Net transfers to affiliates	(178,820)	
Cash applied for financing and miscellaneous uses:		
Dividends to stockholders paid	(1,839,000)	
Net cash from financing and miscellaneous sources		(2,017,820)
Reconciliation		
Net change in cash and short-term investments		(1,260,237)
Cash and short-term investments, December 31, 2001		1,706,892
Cash and short-term investments, December 31, 2002		$ 446,655

Fidelity and Guaranty Insurance Underwriters, Inc.
Compulsory and Security Surplus Calculation
December 31, 2002

Assets	$46,708,506
Less liabilities	(7,450)
Adjusted surplus	46,701,056
Compulsory surplus (subject to a minimum of $2 million)	2,000,000
Compulsory surplus excess (or deficit)	$44,701,056
Adjusted surplus (from above)	$46,701,056
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million, with a minimum factor of 110%)	2,800,000
Security surplus excess (or deficit)	$43,901,056

Fidelity and Guaranty Insurance Underwriters, Inc.
Reconciliation and Analysis of Surplus
For the Two-Year Period Ending December 31, 2002

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	2002	2001
Surplus, beginning of year	46,049,580	47,931,611
Net income	2,490,476	2,595,970
Dividends to stockholders	(1,839,000)	(4,478,000)
Surplus, end of year	46,701,056	46,049,580

The failure to add to the totals shown is due to rounding.

Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2002

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below. Ratios that involve net underwriting results are zero due to the 100% ceding reinsurance agreement with USF&G.

	Ratio	2002	2001	2000	1999	1998
#1	Gross Premium to Surplus	303%	442%	499%	521%	730%
#2	Net Premium to Surplus					
#3	Change in Net Writings					
#4	Surplus Aid to Surplus					
#5	Two-Year Overall Operating Ratio					
#6	Investment Yield	5.5	5.7	6.0	5.9	6.2
#7	Change in Surplus	1.2	(4.2)	0.3	(2.2)	5.9
#8	Liabilities to Liquid Assets					
#9	Agents' Balances to Surplus					
#10	One-Year Reserve Devel. to Surplus					
#11	Two-Year Reserve Devel. to Surplus					
#12	Estimated Current Reserve Def. To Surplus					

Investment yields have decreased largely due to the depressed investment market. The change in surplus during the examination period is due solely to the accumulation of investment income less the payment of dividends.

Growth of Fidelity and Guaranty Insurance Underwriters, Inc.

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
2002	$46,708,506	$7,450	$46,701,056	$2,490,476
2001	46,024,361	(25,220)	46,049,580	2,595,970
2000	48,265,998	334,387	47,931,611	2,845,515
1999	48,135,319	53,223	48,082,096	2,744,794
1998	49,157,302	0	49,157,302	2,730,403
1997	46,600,365	173,466	46,426,899	3,347,806

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
2002	$141,526,375	None*	None*	0.0%	0.0%	0.0%
2001	203,667,214					
2000	239,240,481					
1999	250,630,287					
1998	359,079,510					
1997	431,734,260					

*The company cedes 100% of its premium to two affiliate reinsurers.

The company's gross premium written has decreased 67% from $431,734,260 in 1997 to $141,526,375 in 2002 as the St. Paul Group exits what it has determined as unprofitable product lines. The company cedes 100% of its premium to an affiliate. Assets and surplus have remained relatively unchanged because the company retains no net underwriting results and regularly pays its investment income out to its parent in the form of dividends. Income from investments has decreased 26% from $3,347,806 in 1997 to $2,490,476 in 2002 largely due to the depressed investment market.

Reconciliation of Surplus per Examination

No changes to surplus or reclassifications were made as a result of this examination.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were four specific comments and recommendations in the previous examination report. Comments and recommendations contained in the previous examination report and actions taken by the company are as follows:

1. Management and Control—It is recommended that the company conduct business according to its articles of incorporation and by-laws and that committees should be made up of board members only pursuant to s. 180.0825, Wis. Stat.

   Action—Compliance.

2. Reinsurance Contracts—It is again recommended that the company rewrite its reinsurance agreement to be in compliance with s. Ins 52.03 (3) (b), Wis. Adm. Code, and also meet the current standards of the NAIC Model Law for Credit Reinsurance and submit, within 90 days of the adoption of this report, such amended agreements to this office, pursuant to s. Ins 40.04(2), Wis. Adm. Code.

   Action—Compliance.

3. Investments Cash—It is recommended that the company report all bank accounts of the company on the Annual Statement according to the NAIC Annual Statement Instructions – Property and Casualty.

   Action—Compliance.

4. Affiliated Balances—It is recommended that the company review all of its affiliated agreements and either change the affiliated agreements to reflect the current settlement procedures or settle according to the terms of the current agreements, and submit amended agreements within 90 days, pursuant to s. Ins 40.04(2), Wis. Adm. Code.

   Action—Compliance.

Summary of Current Examination Results

There are no specific comments and recommendations as a result of this examination report.

VIII. SUBSEQUENT EVENTS

Planned Merger with Travelers Property Casualty Corporation

On November 16, 2003, SPC entered into an agreement and plan of merger with Travelers Property Casualty Corporation (Travelers) that will create the nation's second largest commercial insurer. The transaction is expected to close in the second quarter of 2004, and the combined entity is expected to have total assets of $107 billion, shareholder's equity of $20 billion, total capital of $26 billion and net written premiums of $20 billion. The company anticipates that restructuring charges in conjunction with the merger will be approximately $300-400 million.

The merger will be structured as a tax-free, stock-for-stock merger, and will be treated as a purchase business combination of SPC by Travelers under accounting principles generally accepted in the United States of America. In this merger, the acquired entity (SPC) will issue the equity interests and this business combination meets the criteria of a reverse acquisition. Each share of Travelers Class A common stock and Class B common stock will be exchanged for 0.4334 shares of SPC common stock. The resulting company will be known as The St. Paul Travelers Companies, will remain a Minnesota corporation and will have its corporate headquarters in St. Paul, Minnesota.

The transaction has been approved by the Boards of both companies, and was approved by the Federal Trade Commission in December, 2003. It remains subject to approval of the shareholders of both companies as well as regulatory approvals by several states.

Western MacArthur Asbestos Settlement Agreement

SPC announced on June 30, 2002, that it had entered into an agreement settling all existing and future claims arising from any insuring relationship of USF&G, SPC and its affiliates with any of MacArthur Company, Western MacArthur Company, and Western Asbestos Company, collectively known as the MacArthur Companies.

On November 22, 2002, pursuant to the provisions of the settlement agreement, the MacArthur Companies filed voluntary petitions under Chapter 11 of the Bankruptcy Code to permit the channeling of all current and future asbestos-related claims solely to a trust to be established pursuant to Section 542(g) of the Bankruptcy Code. Consummation of most elements of the settlement agreement is contingent upon bankruptcy court approval of the settlement agreement as part of a broader plan for the reorganization of the MacArthur Companies (the Plan). Approval of the Plan involves substantial uncertainties that include the need to obtain agreement among existing asbestos plaintiffs, a person to be appointed to represent the interests of unknown, future asbestos plaintiffs, the MacArthur Companies and SPC and its subsidiaries as to the terms of such Plan. Accordingly, there can be no assurance that bankruptcy court approval of the Plan will be obtained.

Upon final approval of the Plan, the MacArthur Companies will release SPC and its subsidiaries from any and all asbestos-related claims for personal injury, and all other claims in excess of $1 million in aggregate, that may be asserted relating to or arising from, directly or indirectly, any alleged coverage provided by SPC or its subsidiaries to any MacArthur Companies, including any claim for extra-contractual relief.

The after-tax impact on USF&G's earnings in 2002, net of expected reinsurance recoveries and the revaluation and application of asbestos and environmental reserves, was approximately $354 million.

On January 16, 2003, USF&G made a payment of $740 million, plus $7 million in interest, related to the Western MacArthur settlement. This amount, along with $60 million of an initial $235 million payment made by USF&G in the second quarter of 2002, is being held in escrow pending final bankruptcy court approval of the settlement agreement as part of a broader plan for the reorganization of the MacArthur Companies. These payments would be returned to USF&G if the Plan is not approved by the bankruptcy court.

The settlement agreement also provided for USF&G to pay $13 million (which was paid in the second quarter of 2002) and to advance certain fees and expenses incurred in connection with the settlement, bankruptcy proceedings, finalization of the Plan and efforts to achieve approval of the Plan, subject to a right of reimbursement in certain circumstances of amounts advanced.

As a result of the settlement, pending litigation with the MacArthur Companies has been stayed pending final approval of the Plan. Whether or not the Plan is approved, up to $175 million of the $235 million will be paid to counsel for the MacArthur Companies, and persons holding judgments against the MacArthur Companies as of June 3, 2002, and their counsel, and SPC and its subsidiaries will be released from claims by such holders to the extent of $110 million paid to such holders.

IX. CONCLUSION

The December 31, 2002, examination of Fidelity and Guaranty Insurance Underwriters Inc., resulted in no adjustments to the reported surplus of $46,701,056. The company's gross premium written has decreased 67% from $431,734,260 in 1997 to $141,526,375 in 2002 as the parent company exits what it has determined as unprofitable product lines. The company cedes 100% of its premium to an affiliate. Assets and surplus have remained relatively unchanged because the company retains no net underwriting results and regularly pays its investment income out to its parent in the form of dividends. Income from investments has decreased 26% from $3,347,806 in 1997 to $2,490,476 in 2002 largely due to the depressed investment market.

The company reported $141,526,375 as direct written premiums, which represents approximately 18% of the total net written premiums reported by USF&G. The company cedes 100% of its business to its parent, USF&G.

On November 16, 2003, The St. Paul Companies, Inc., entered into an agreement and plan of merger with Travelers Property Casualty Corporation (Travelers) that will create the nation's second largest commercial insurer. The transaction is expected to close in the second quarter of 2004, and the combined entity is expected to have total assets of $107 billion, shareholder's equity of $20 billion, total capital of $26 billion and net written premiums of $20 billion. The company anticipates that restructuring charges in conjunction with the merger will be approximately $300-400 million.

X. SUMMARY OF COMMENTS AND RECOMMENDATIONS

There are no specific comments and recommendations as a result of this examination report.

XI. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company and the Minnesota Department of Commerce, who acted as Lead State in the multi state examination, is acknowledged.

Respectfully submitted,

Russell Lamb, CPA
Examiner-in-Charge